



Legislative Audit Division

State of Montana

Report to the Legislature

March 2003

Financial-Compliance Audit For the Two Fiscal Years Ended June 30, 2002

Department of Military Affairs

This report contains five recommendations covering:

- ▶ **Accounting and Management Controls.**
- ▶ **Compliance with State Laws and Regulations.**
- ▶ **Youth Challenge Matching Funds.**
- ▶ **Federal Cash Management Procedures.**

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Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2003, will be issued by March 31, 2004. The Single Audit Report for the two fiscal years ended June 30, 2001, was issued on March 26, 2002. Copies of the Single Audit Report can be obtained by contacting:

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March 2003

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Military Affairs for the two fiscal years ended June 30, 2002. Included in this report are recommendations concerning accounting and management controls, the National Guard Youth Challenge matching funds, federal cash management procedures, and compliance with state laws.

The department's written response to the audit recommendations is included at the end of the audit report. We thank the Adjutant General and his staff for their assistance and cooperation.

Respectfully submitted,

(Signature on File)

Scott A. Seacat
Legislative Auditor

Legislative Audit Division

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 2002

Department of Military Affairs

Members of the audit staff involved in this audit were John Fine, Brenda Kedish, Jim Manning, and Sonia Powell.

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Appointed and Administrative Officials

Department of Military Affairs

John E. Prendergast	Adjutant General
Randy Mosley	Deputy Director
Karen Revious	Administrator Centralized Services Division
Jim Greene	Administrator Disaster and Emergency Services Division
Joseph Foster	Administrator Veterans' Affairs Division
Mike Royer	Administrator Youth Challenge Program

Board of Veterans' Affairs

Term Expires

Donald Bogut, Chairman	August 2006
Karen Furu	August 2003
Donald Kettner	August 2004
Ruben McKinney	August 2005
Ray Tindall	August 2007

Department of Military Affairs

This report contains five recommendations directed to the department. The first section in the report discusses ways in which the department can improve controls over financial management and recording transactions in compliance with state accounting policy. It discusses issues relating to appropriate recording of expenditure amounts, compliance with state accounting policy, and implementing procedures to improve communication and coordination between program managers and accounting personnel.

The second section of this report discusses ways the department can improve compliance with state laws. There are two recommendations addressing timely repayment of inter-entity loans and final vacation leave payouts.

The third section of the report addresses ways the department can improve compliance with federal laws and regulations. There are two recommendations in this section addressing compliance with federal cash management and Youth Challenge program matching requirements.

We issued a qualified opinion on the financial schedules contained in this report for each of the two fiscal years audited. This means the reader should use caution when using the presented financial information and the supporting data on the state's accounting records.

The listing below serves as a means of summarizing the recommendations contained in the report, the department's response thereto, and a reference to the supporting comments.

Recommendation #1

We recommend the department:

- A. Implement procedures to improve communications and coordination among program managers and accounting personnel.

Report Summary

Department Response: Concur. See page B-3.

- B. Provide training for its program managers and accounting staff with regard to current state accounting policies.

Department Response: Concur. See page B-3.

- C. Implement procedures to ensure transactions are recorded in compliance with state accounting policy..... 10

Department Response: Concur. See page B-3.

Recommendation #2

We recommend the department repay inter-entity loans within one year, as required by state law..... 11

Department Response: Concur. See page B-3.

Recommendation #3

We recommend the department comply with state personnel policies regarding payout of vacation benefits when employees terminate..... 11

Department Response: Concur. See page B-4.

Recommendation #4

We recommend the department implement procedures to ensure the CMIA spreadsheets contain accurate information in order to document compliance with the CMIA agreement..... 13

Department Response: Concur. See page B-4.

Recommendation #5

We recommend the department comply with federal matching requirements for the Youth Challenge program. 14

Department Response: Concur. See page B-4.

Introduction

Introduction

We performed the financial-compliance audit of the Department of Military Affairs (department) for the two fiscal years ended June 30, 2002. The objectives of the audit were to:

1. Determine if the department complied with applicable state and federal laws and regulations.
2. Obtain an understanding of the department's control systems, and, if appropriate, make recommendations for improvement in the internal and management controls of the department.
3. Determine the implementation status of prior audit recommendations.
4. Determine if the department's financial schedules fairly present the results of operations for the two fiscal years ended June 30, 2002.

This report contains five recommendations to the department. These recommendations address areas where the department can improve internal controls, accounting procedures, and compliance with laws and regulations. Areas of concern deemed not to have a significant effect on the successful operations of the department are not specifically included in the report, but have been discussed with management.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the cost, if significant, of implementing the recommendations in this report.

Background

The department was created under the Executive Reorganization Act of 1971. The department consists of the Montana National Guard program, Military Construction program, Centralized Services Division, Disaster and Emergency Services program, Veterans' Affairs Division, and the Youth Challenge program.

The Montana National Guard is authorized approximately 66 full-time equivalent (FTE) positions that are paid through the state's payroll system. An additional 770 full-time personnel are paid through the federal payroll system. The Montana National Guard

Introduction

has two programs – the Air National Guard and the Army National Guard. The Air National Guard provides firefighting personnel, maintenance, and support for Air National Guard facilities at Great Falls. The Army National Guard provides administration, maintenance, and support for facilities and training areas throughout the state. The mission of both programs is to provide the necessary facilities to support the Montana National Guard in the event of a state or national emergency.

Centralized Services Division (CSD) is authorized approximately 9 FTE. It is the primary administrative support organization for the department, including financial management, budgeting, personnel, and other administrative functions.

The Disaster and Emergency Services Division (DES) works with local, state, and federal officials to prepare, update, and coordinate emergency preparedness, response and recovery plans. DES provides technical support for civil defense shelters, exercises, and radiological defense and monitoring. The division also receives, records, and disburses federal funds to eligible political subdivisions. DES is authorized 22 FTE.

The Montana National Guard Youth Challenge Program (Challenge) is a volunteer program for youth ages 16 to 18 who have stopped attending secondary school before graduating. Challenge is a 17-month, voluntary, two-phased military modeled training program targeting unemployed, drug-free, non-felons, not currently under judicial supervision, high school dropouts. The program provides an opportunity for high school age at-risk youth to enhance their life skills, increase their educational levels, and increase their employment potential. The Challenge program is authorized 43 FTE.

The Veterans' Affairs Division (VA) is authorized approximately 20 FTE and is responsible for assisting Montana's veterans and dependents in obtaining veterans' benefits. The division provides information on benefits, guidance on completing veterans'

administration forms, and referral to other agencies. The division is attached to the department for administrative purposes. The division administrator is hired by, and reports to, the Board of Veterans' Affairs, a five-member board appointed by the governor and serving with the consent of the senate.

Prior Audit Recommendations

Our office performed the department's financial-compliance audit for the two fiscal years ended June 30, 2000. The audit report contained five recommendations to the department. The department implemented three recommendations, partially implemented one recommendation, and did not implement one recommendation.

The partially implemented recommendation relates to the timely reimbursement of valid expenditures by the federal government and is discussed on page 12 of this report. The recommendation not implemented relates to the collection of unallowable travel expenses previously paid and is discussed on page 9 of this report.

Performance Audit Board of Veterans' Affairs and Veterans' Affairs Division

Our office also conducted a performance audit of the Montana Board of Veterans' Affairs and the Veterans' Affairs Division of the department. The performance audit (02P-07) issued in June 2002 contained eight recommendations.

We coordinated our financial-compliance audit with our performance audit.

Findings and Recommendations

Accounting/Management Controls

The Department of Military Affairs uses the modified accrual basis of accounting as defined by state accounting policy for recording General Fund, Special Revenue Fund, and Capital Projects Fund transactions. Under the modified accrual presentation, revenues are recorded when the department receives cash or when receipts are measurable and available to pay current period liabilities; expenditures are recorded for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. During this audit, we noted that expenditures were not always recorded in accordance with state accounting policy. The following sections discuss instances where the department could improve compliance with state accounting policy and strengthen management controls.

Prepaid Expense Classification

During fiscal year 2001, the department recorded fire fighting expenditures and construction expenditures against a prepaid expense category. These expenditures did not meet the prepaid expense classification, since the charges were incurred for valid obligations which were measurable, and for which the department was liable, during fiscal year 2001. Classification of expenditures as "prepaid" essentially pays the charge while showing the cost as an asset, since it is deemed paid in advance of the liability. This classification also circumvents the budget approval requirement in the Statewide Budgeting, Accounting, and Human Resources System (SABHRS), allowing the charges to be paid without being posted against a valid appropriation. This violates the Montana State Constitution, Section 14, Article 8, which states, "Except for interest on the public debt, no money shall be paid out of the treasury unless upon an appropriation made by law. . ."

Agency staff indicated that, due to the nature of the fire season, appropriation authority was exhausted during fiscal year 2001. Although the department eventually received \$2,071,581 from the Federal Emergency Management Agency (FEMA) to reimburse these expenditures, they did not receive additional appropriation authority until the amounts were negotiated with FEMA and with other agencies involved (i.e., Department of Natural Resources &

Findings and Recommendations

Conservation, U.S. Forest Service, and county agencies). The magnitude of the fires, and the fact that this was the first time counties were included in the reimbursement process, further complicated the process.

The department also made an error when it recorded \$155,734 of construction expenditures against the wrong appropriation, causing expenditures to exceed the appropriation limit. The department reversed the expenditure and incorrectly recorded a prepaid expense. In the following fiscal year the department recorded the expense against the correct appropriation.

As a result of classifying these types of expenditures as “prepaid expenditures” on the department’s accounting records and in the department’s financial schedules, expenditures included in this report are understated by \$2,227,315 in fiscal year 2000-01 and overstated by the same amount in fiscal year 2001-02. This resulted in a qualified opinion on page A-3.

Retainage

The Facilities Contracting and Construction unit plans and oversees the department’s major construction projects throughout the state. As part of its oversight, this unit processes contractor payments, including retainage and the contractors’ gross receipt tax withholdings.

Retainage is calculated as a percentage of the work completed and withheld from the periodic bills submitted by a contractor. Because the amount retained is a valid obligation of the state, it must be classified as a liability. This classification ensures amounts that were earned by the contractor, and owed by the state, are recorded as expenditures in the appropriate accounting period.

During the two fiscal years ended June 30, 2001 and 2002, the department did not record liabilities for the retainage amounts withheld from contractor payments. During our audit work, we informed accounting staff that a retainage entry was required by state

Findings and Recommendations

accounting policy. When we asked why an entry was not made for fiscal year-end 2001-02, personnel replied that the Facilities Contracting and Construction Division did not provide the retainage information. When we asked these personnel why they did not provide the information, they replied that they were never asked for it.

Because retainage entries were not made at fiscal year-end, contractor payment expenditures were understated by at least \$59,223 in fiscal year 2000-01, and at least \$253,131 in fiscal year 2001-02.

Improper Cutoff of Expenditures

During our audit, we identified two instances where charges were expensed to the wrong fiscal year. Communication charges of at least \$12,056 and contractor payments of \$82,172 should have been expensed in fiscal year 2001-02 rather than in fiscal year 2002-03. As a result, expenditure amounts were understated in fiscal year 2001-02 by \$94,228 and overstated in fiscal year 2002-03 by the same amount. State accounting policy requires that transactions should be recorded in the proper year and provides guidance and procedures for agencies to ensure transactions are properly recorded.

CSD personnel receive the communications billings from the department's communications personnel and pay accordingly. Communications personnel break the charges out by federal fiscal year rather than state fiscal year. CSD personnel received the communications bill showing a previous balance, but did not have invoices breaking down the balance. As a result, the entire bill was expensed in fiscal year 2002-03. CSD personnel should request information to determine the state fiscal year to which these expenditures should be charged.

For contractor payments, program managers specify the fiscal year to be charged on their invoice approval forms, but accounting personnel do not check the fiscal year information when they pay claims. One contractor invoice we reviewed specifically identified services

Findings and Recommendations

performed in June of 2002, but the amount was recorded as a fiscal year 2002-03 expenditure.

CSD personnel stated that some of the program managers do not understand proper accounting procedures. However, the final input and processing of invoices is performed by Centralized Services Division staff, who should be familiar with accounting policies.

Capital Projects Funds

During fiscal year 2000-01, the department established a Capital Projects Fund, in accordance with our prior audit recommendation. A Capital Projects Fund is used to account for resources associated with the construction or purchase of a state facility.

Entries made in the Capital Projects Fund in fiscal year 2001-02 reflect costs associated with the design phase of the Kalispell Armed Forces Reserve Center. Because this phase of the project was completed, ending fund balance should have been zero at the end of 2002. Due to a duplicate revenue entry of \$174,631, and a retainage adjustment of \$9,741, revenues and ending fund balance were overstated by \$184,372 in the Capital Projects Fund and understated by this amount in the Federal Special Revenue Fund for fiscal year-end 2002.

Department staff discovered and corrected this error in fiscal year 2002-03. However, a review of fund balance amounts prior to fiscal year-end closeout would have allowed staff to correct the accounting records before the fiscal year's accounting records were closed.

Asset Management Entries

State accounting policy requires that long-lived assets with costs exceeding established thresholds be recorded on the Asset Management module in SABHRS. Recording assets on Asset Management ensures that the state has a record of equipment, buildings, and other improvements purchased by each agency. In addition, the construction-in-process category on Asset Management allows the state to keep track of construction projects that are not yet completed, but still represent an investment of agency resources with future value to the agency upon project completion.

Findings and Recommendations

During fiscal year 2002, the department did not update its state equipment, buildings, and construction work-in-process entries on SABHRS. As a result, \$1.19 million in finished construction and at least \$20,000 in vehicle purchases were not recorded properly on the Asset Management module.

Staff indicated they were unfamiliar with using the SABHRS Asset Management module. In addition, asset ownership also has to be researched by staff, since assets are purchased under separate federal/state funding allocations. Asset Management entries are currently being researched and updated by staff, but as of January 2003, the entries were not completed.

Unsigned Travel Vouchers/ Non-Collection of Unallowed Payment

During our previous audit of the department we noted an instance where an employee based in Helena charged vehicle mileage between his home in Butte and his designated worksite in Helena. As a result, the department paid \$2,100 in unallowable travel expenses. We recommended the department review travel vouchers to ensure charges for travel comply with state policy and collect reimbursement for the unallowable travel expenses paid. During our current audit we determined the department did not collect reimbursement for the unallowable travel expenses paid and took minimal steps towards collection. We also reviewed travel expenses submitted for three pay periods. We noted six instances where travel vouchers were not signed by a supervisor.

Management Control Summary

The department's management controls did not detect or prevent the accounting and payment errors noted in the preceding sections. Amounts were incorrectly classified as pre-paid expenditures, recorded in the wrong fiscal year, and not properly reported on the Asset Management system.

Responses from department personnel indicate that there are problems associated with obtaining accurate information from program managers and other staff who track expenditures within their programs. One federal employee insisted expenditure amounts he processed did not flow through the state's accounting system,

Findings and Recommendations

even though these costs are paid through SABHRS and reimbursed by the federal government. Accounting personnel were also unfamiliar with state accounting policies related to recording contractor retainage liabilities. Based on our audit of the department and the significant errors we found, we believe the department should implement procedures for improved communications and coordination among program managers and accounting personnel. In addition, the department should provide additional training for program managers and accounting staff, so they learn and can comply with current state accounting policies.

Recommendation #1

We recommend the department:

- A. Implement procedures to improve communications and coordination among program managers and accounting personnel.**
- B. Provide training for its program managers and accounting staff with regard to state accounting policies.**
- C. Implement procedures to ensure transactions are recorded in compliance with state accounting policy.**

State Compliance Issues

As part of our audit work, we reviewed departmental compliance with state laws and regulations. We identified several instances of noncompliance with state laws and regulations. These issues are discussed below.

Loan Obligations Not Repaid in a Timely Manner

The Department of Administration allows agencies to temporarily borrow funds when they experience a negative cash situation, especially at fiscal year-end. Section 17-2-107, MCA, requires there must be reasonable evidence that the agency's income will be sufficient to repay the loan within one calendar year.

During fiscal years 2000-01 and 2001-02, the department did not pay back loans within one year of the loan date, as required by state law. During fiscal year 2000-01, loans were simultaneously paid off and then re-borrowed. At fiscal year-end 2001-02, the department owed

Findings and Recommendations

\$1,425,000 in loans that were not paid within the one-year deadline. As of December 27, 2002, \$820,000 was still owed from loans taken out at fiscal year-end 2000-01.

Staff indicated that they operate on a reimbursement basis, so delays occur between the payment of expenditures and reimbursement by the federal government. Delays in federal reimbursements, however, do not explain the extended loan periods we found during this audit.

Recommendation #2

We recommend the department repay inter-entity loans within one year, as required by state law.

Improper Vacation Leave Payout

Under state personnel policies, all permanent, seasonal, and temporary employees are eligible to earn vacation leave. In order to use this leave, or receive a payout of accumulated vacation, an employee must be continuously employed for the qualifying period of six calendar months. An employee is not eligible to take vacation, or to receive a cash payout for accumulated vacation, until the day after the six-month qualifying period.

During fiscal year 2001, an employee of the department was given a vacation payout when he had not worked the six-month qualifying period. This employee submitted his final timesheet charging hours through the 24th of the month, three days prior to his six-month anniversary and four days prior to the date he was eligible to receive these benefits. The department inappropriately paid vacation benefits in the amount of \$1,257 to this employee on his final paycheck.

Recommendation #3

We recommend the department comply with state personnel policies regarding payout of vacation benefits when employees terminate.

Findings and Recommendations

Federal Compliance

We reviewed the department's compliance with federal laws and regulations, in accordance with the Single Audit Act Amendments of 1996, OMB Circular A-133, and Government Auditing Standards. The department did not comply with federal matching requirements for the National Guard Youth Challenge Program (Challenge). The department also did not comply with provisions of the Cash Management Improvement Act (CMIA). These issues are discussed below.

Cash Management

The department receives federal assistance from the Department of Defense by requesting reimbursement for allowable costs. OMB Circular A-133 requires entities receiving federal funds to follow provisions of the Cash Management Improvement Act (CMIA) agreement between the State of Montana and the U.S. Treasury for federal assistance programs covered by the agreement. The CMIA agreement stipulates two warrant clearance patterns for the department. For Operations and Maintenance projects, there is a four-day clearance pattern; for Construction project payments, there is a three-day clearance pattern. Based on these patterns, the department should receive federal reimbursement for expenditures within three or four days of warrants being issued, depending upon which program is issuing the warrants.

We addressed cash management problems in each of the last three audits of the department. During our prior audit, we recommended the department ensure timely reimbursement of valid expenditures by the federal government and restructure accounting control procedures to ensure federal budget verification checks occur prior to paying vendors. The department did establish controls relating to the federal budget checks occurring prior to the payment of bills. However, the department continues to experience problems with the reimbursement process.

State policy requires the department to prepare spreadsheets to track clearance patterns that aid in documenting compliance with the CMIA agreement. Information from the spreadsheets is used by the Department of Administration to determine any federal or state

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interest liabilities. During fiscal year 2001, the Department of Administration requested and received interest payments from the federal government, because spreadsheet calculations showed that the federal government was not reimbursing expenditures in a timely manner. However, subsequent work determined that the calculations were in error.

The department noted procedures performed by an outside CPA firm identified errors and inconsistencies with the fiscal year 2001 worksheet used to track warrant clearance patterns for the Operations and Maintenance program. Their report indicated that the data in the worksheet might be unreliable. Department staff explained that during fiscal year 2001, a different system was in place to pay bills. Employees were inputting bills each day into the accounting system for payment, and this information was used to construct the warrant clearance pattern worksheet. Vouchers requesting reimbursement were prepared weekly, but bills were not always included in that week's reimbursement request. As a result, clearance pattern calculations showed delays in payment, when the voucher for reimbursement had not even been submitted.

In response to the CPA firm's recommendation, the department submitted a revised worksheet tracking when reimbursements were requested and modifying warrant issuance dates and programs charged. As a result of these revisions, the state may owe approximately \$55,000 back to the federal government. As noted in our prior audit the department should continue to improve accounting controls, expedite workflow, and improve compliance with cash management requirements.

Recommendation #4

We recommend the department implement procedures to ensure the CMIA spreadsheets contain accurate information in order to document compliance with the CMIA agreement.

Findings and Recommendations

attending secondary school before graduating. The program provides an opportunity for high school age, at-risk youth to enhance their life skills and increase their educational levels and employment potential. The department operates the Challenge program in Dillon, Montana.

In order to receive federal funding for the Challenge program, the state must provide a portion of the total funding as “match” for the federal funds received. For fiscal year 2001, the required state match was 35 percent of the total funding.

The Federal Uniform Requirements for Grants and Cooperative Agreements state, “Except as provided by Federal statute, a cost sharing or matching requirement may not be met by costs borne by another Federal grant.” During fiscal year 2001, the federal government provided \$1,762,404 in funding. Based on the percent match rate, the state needed to provide \$948,987 in matching funds. The state provided a total of \$771,793 in funds, which was \$177,194 less than the required match amount.

The department indicated that it had used federal funds, obtained from the Workforce Investment Act (WIA), to meet state match requirements. Because federal funds cannot be used to meet state match requirements, the state match requirement was not met. We question \$329,074 of federal costs.

Recommendation #5

We recommend the department comply with federal matching requirements for the Youth Challenge program.

Independent Auditor's Report & Department Financial Schedules

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel



Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances and Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Military Affairs for each of the fiscal years ended June 30, 2001 and 2002. The information contained in these financial schedules is the responsibility of the department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosure in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are presented on a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the department's assets, liabilities, and cash flows.

The department recorded \$2,227,315 of General Fund expenditures in the wrong year. As a result, fiscal year 2000-01 expenditures are understated and fiscal year 2001-02 expenditures are overstated in the General Fund on the Schedules of Total Expenditures and Transfers-Out for the fiscal years ended June 30, 2001 and June 30, 2002, respectively. Fund Balance at June 30, 2001, is overstated by \$2,227,315 in the General Fund on the Schedule of Changes in Fund Balances for the fiscal year then ended.

In fiscal year 2002, the department made a duplicate revenue entry of \$174,631 in the Capital Projects Fund. As a result, Total Additions and Fund Balance at June 30, 2002 are each overstated by \$174,631

in the Capital Projects Fund, on the Schedule of Changes in Fund Balances and Property Held in Trust for the fiscal year ended June 30, 2002.

In our opinion, except for the matters discussed in the preceding two paragraphs, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances of the department for each of the fiscal years ended June 30, 2001 and 2002, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

(Signature on File)

James Gillett, CPA
Deputy Legislative Auditor

January 8, 2003

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2002

	<u>General Fund</u>	<u>Special Revenue Fund</u>	<u>Capital Projects Fund</u>	<u>Agency Fund</u>
FUND BALANCE: July 1, 2001	\$ <u>1,878,762</u>	\$ <u>673,145</u>	\$ <u>0</u>	\$ <u>0</u>
PROPERTY HELD IN TRUST: July 1, 2001				<u>0</u>
ADDITIONS				
Budgeted Revenues & Transfers-In	19,499,995	40,464,883	460,105	
NonBudgeted Revenues & Transfers-In	1,362	140,268		
Prior Year Revenues & Transfers-In Adjustments	771	(166,349)		
Direct Entries to Fund Balance	(14,409,595)	(1,495,627)		
Additions To Property Held in Trust				791
Total Additions	<u>5,092,533</u>	<u>38,943,175</u>	<u>460,105</u>	<u>791</u>
REDUCTIONS				
Budgeted Expenditure & Transfers-Out	7,367,963	39,466,260	275,733	
Prior Year Expenditure & Transfers-Out Adjustments	(24,598)	(57,959)		
Reductions in Property Held in Trust				791
Total Reductions	<u>7,343,365</u>	<u>39,408,301</u>	<u>275,733</u>	<u>791</u>
FUND BALANCE: June 30, 2002	\$ <u><u>(372,070)</u></u>	\$ <u><u>208,019</u></u>	\$ <u><u>184,372</u></u>	
PROPERTY HELD IN TRUST: June 30, 2002				\$ <u><u>0</u></u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF CHANGES IN FUND BALANCES
FOR THE FISCAL YEAR ENDED JUNE 30, 2001

	<u>General Fund</u>	<u>Special Revenue Fund</u>	<u>Capital Projects Fund</u>
FUND BALANCE: July 1, 2000	\$ <u>(315,020)</u>	\$ <u>276,330</u>	\$ <u>0</u>
ADDITIONS			
Budgeted Revenues & Transfers-In	24,402,117	43,738,882	52,974
NonBudgeted Revenues & Transfers-In	9,261	139,662	
Prior Year Revenues & Transfers-In Adjustments		(458,674)	
Direct Entries to Fund Balance	<u>(13,307,404)</u>	<u>(590,135)</u>	
Total Additions	<u>11,103,974</u>	<u>42,829,735</u>	<u>52,974</u>
REDUCTIONS			
Budgeted Expenditure & Transfers-Out	8,938,007	42,573,482	52,974
Prior Year Expenditure & Transfers-Out Adjustments	(27,815)	(140,562)	
Total Reductions	<u>8,910,192</u>	<u>42,432,920</u>	<u>52,974</u>
FUND BALANCE: June 30, 2001	\$ <u><u>1,878,762</u></u>	\$ <u><u>673,145</u></u>	\$ <u><u>0</u></u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2002

	<u>General Fund</u>	<u>Special Revenue Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
TOTAL REVENUES & TRANSFERS-IN BY CLASS				
Licenses and Permits		\$ 3,557		\$ 3,557
Taxes	\$ 1,278			1,278
Charges for Services	41,160	64,063		105,223
Rentals, Leases and Royalties		175		175
Grants, Contracts, Donations and Abandonments		5,320		5,320
Other Financing Sources	16,564,335	130,130	\$ 460,105	17,154,570
Federal	2,895,355	40,235,557		43,130,912
Total Revenues & Transfers-In	<u>19,502,128</u>	<u>40,438,802</u>	<u>460,105</u>	<u>60,401,035</u>
Less: Nonbudgeted Revenues & Transfers-In	1,362	140,268		141,630
Prior Year Revenues & Transfers-In Adjustments	771	(166,349)		(165,578)
Actual Budgeted Revenues & Transfers-In	<u>19,499,995</u>	<u>40,464,883</u>	<u>460,105</u>	<u>60,424,983</u>
Estimated Revenues & Transfers-In	4,320,000	26,800,196	7,405,175	38,525,371
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ 15,179,995</u>	<u>\$ 13,664,687</u>	<u>\$ (6,945,070)</u>	<u>\$ 21,899,612</u>
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS				
Licenses and Permits		\$ (118,861)		\$ (118,861)
Charges for Services	\$ 20,305	(118,280)		(97,975)
Rentals, Leases and Royalties		(25,675)		(25,675)
Grants, Contracts, Donations and Abandonments		(14,680)		(14,680)
Other Financing Sources	15,064,335	(169,870)	\$ (6,945,070)	7,949,395
Federal	95,355	14,112,053		14,207,408
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ 15,179,995</u>	<u>\$ 13,664,687</u>	<u>\$ (6,945,070)</u>	<u>\$ 21,899,612</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2001

	<u>General Fund</u>	<u>Special Revenue Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
TOTAL REVENUES & TRANSFERS-IN BY CLASS				
Licenses and Permits		\$ 107,902		\$ 107,902
Taxes	\$ 3,107			3,107
Charges for Services	14,239	19,997		34,236
Rentals, Leases and Royalties		2,575		2,575
Miscellaneous	6,155			6,155
Grants, Contracts, Donations and Abandonments		8,275		8,275
Other Financing Sources	24,387,877		\$ 52,974	24,440,851
Federal		43,281,121		43,281,121
Total Revenues & Transfers-In	<u>24,411,378</u>	<u>43,419,870</u>	<u>52,974</u>	<u>67,884,222</u>
Less: Nonbudgeted Revenues & Transfers-In	9,261	139,662		148,923
Prior Year Revenues & Transfers-In Adjustments		(458,674)		(458,674)
Actual Budgeted Revenues & Transfers-In	<u>24,402,117</u>	<u>43,738,882</u>	<u>52,974</u>	<u>68,193,973</u>
Estimated Revenues & Transfers-In	19,000	9,655,952	145,519	9,820,471
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ 24,383,117</u>	<u>\$ 34,082,930</u>	<u>\$ (92,545)</u>	<u>\$ 58,373,502</u>
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS				
Licenses and Permits		\$ (3,023)		\$ (3,023)
Charges for Services	\$ 9,239	(40,003)		(30,764)
Rentals, Leases and Royalties		(22,425)		(22,425)
Grants, Contracts, Donations and Abandonments		(31,725)		(31,725)
Other Financing Sources	24,377,878		\$ (92,545)	24,285,333
Federal		34,180,106		34,180,106
Federal Indirect Cost Recoveries	(4,000)			(4,000)
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ 24,383,117</u>	<u>\$ 34,082,930</u>	<u>\$ (92,545)</u>	<u>\$ 58,373,502</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2002

	AIR NATIONAL GUARD PGM	ARMY NATIONAL GUARD PGM	CENTRALIZED SERVICES DIVISION	CHALLENGE PROGRAM	DISASTER & EMERGENCY SERVICES	DISASTER FUND	MILITARY CAPITAL CONSTRUCTION	SCHOLARSHIP PROGRAM	VETERANS AFFAIRS PROGRAM	Total
PROGRAM EXPENDITURES & TRANSFERS-OUT BY OBJECT										
Personal Services										
Salaries	\$ 1,027,298	\$ 1,028,725	\$ 349,895	\$ 1,138,352	\$ 829,837	\$ 482,894	\$ 3,053		\$ 535,613	\$ 5,395,667
Other Compensation									(18,518)	(18,518)
Employee Benefits	<u>287,060</u>	<u>271,017</u>	<u>81,694</u>	<u>338,042</u>	<u>201,510</u>	<u>66,320</u>	<u>720</u>		<u>154,629</u>	<u>1,400,992</u>
Total	<u>1,314,358</u>	<u>1,299,742</u>	<u>431,589</u>	<u>1,476,394</u>	<u>1,031,347</u>	<u>549,214</u>	<u>3,773</u>		<u>671,724</u>	<u>6,778,141</u>
Operating Expenses										
Other Services	247,670	1,103,110	21,892	325,289	67,378	2,319,996	55,641		47,874	4,188,850
Supplies & Materials	102,586	408,971	7,492	224,243	28,295	27,985	1,872		25,147	826,591
Communications	1,315	743,600	4,032	50,095	33,958	4,959	2,422		18,999	859,380
Travel	3,493	77,919	5,998	98,946	87,737	56,944	4,854		14,139	350,030
Rent	227	65,529	515	407,439	227	1,611			22,857	498,405
Utilities	506,749	1,119,911		430					3,990	1,631,080
Repair & Maintenance	42,493	879,079	79	27,647	3,149	53,784	314,559		5,521	1,326,311
Other Expenses	<u>9,269</u>	<u>59,213</u>	<u>13,681</u>	<u>112,922</u>	<u>18,583</u>	<u>14,794</u>		<u>115,875</u>	<u>3,301</u>	<u>347,638</u>
Total	<u>913,802</u>	<u>4,457,332</u>	<u>53,689</u>	<u>1,247,011</u>	<u>239,327</u>	<u>2,480,073</u>	<u>379,348</u>	<u>115,875</u>	<u>141,828</u>	<u>10,028,285</u>
Equipment & Intangible Assets										
Equipment		<u>50,474</u>			<u>2,467</u>	<u>7,402</u>			<u>18,518</u>	<u>78,861</u>
Total		<u>50,474</u>			<u>2,467</u>	<u>7,402</u>			<u>18,518</u>	<u>78,861</u>
Capital Outlay										
Land & Interest In Land							17,569			17,569
Buildings							7,331,790			7,331,790
Other Improvements							<u>2,176,806</u>			<u>2,176,806</u>
Total							<u>9,526,165</u>			<u>9,526,165</u>
Grants										
From State Sources						187,445				187,445
From Federal Sources					<u>936,212</u>	<u>2,640,201</u>				<u>3,576,413</u>
Total					<u>936,212</u>	<u>2,827,646</u>				<u>3,763,858</u>
Benefits & Claims										
To Individuals			<u>2,280</u>							<u>2,280</u>
Total			<u>2,280</u>							<u>2,280</u>
Transfers										
Accounting Entity Transfers						<u>16,564,335</u>	<u>285,474</u>			<u>16,849,809</u>
Total						<u>16,564,335</u>	<u>285,474</u>			<u>16,849,809</u>
Total Program Expenditures & Transfers-Out	\$ <u>2,228,160</u>	\$ <u>5,807,548</u>	\$ <u>487,558</u>	\$ <u>2,723,405</u>	\$ <u>2,209,353</u>	\$ <u>22,428,670</u>	\$ <u>10,194,760</u>	\$ <u>115,875</u>	\$ <u>832,070</u>	\$ <u>47,027,399</u>
PROGRAM EXPENDITURES & TRANSFERS-OUT BY FUND										
General Fund	\$ 185,164	\$ 1,155,155	\$ 394,327	\$ 1,101,077	\$ 505,796	\$ 3,160,921		\$ 115,875	\$ 725,050	\$ 7,343,365
Special Revenue Fund	2,042,996	4,652,393	93,231	1,622,328	1,703,557	19,267,749	\$ 9,919,027		107,020	39,408,301
Capital Projects Fund							<u>275,733</u>			<u>275,733</u>
Total Program Expenditures & Transfers-Out	<u>2,228,160</u>	<u>5,807,548</u>	<u>487,558</u>	<u>2,723,405</u>	<u>2,209,353</u>	<u>22,428,670</u>	<u>10,194,760</u>	<u>115,875</u>	<u>832,070</u>	<u>47,027,399</u>
Less:										
Prior Year Expenditures & Transfers-Out Adjustments	<u>(5,139)</u>	<u>(23,881)</u>	<u>(186)</u>	<u>(37,328)</u>	<u>(957)</u>	<u>0</u>	<u>(1,929)</u>	<u>0</u>	<u>(13,137)</u>	<u>(82,557)</u>
Actual Budgeted Expenditures & Transfers-Out	2,233,299	5,831,429	487,744	2,760,733	2,210,310	22,428,670	10,196,689	115,875	845,207	47,109,956
Budget Authority	<u>2,370,015</u>	<u>6,874,203</u>	<u>503,768</u>	<u>2,833,345</u>	<u>2,743,646</u>	<u>26,146,534</u>	<u>53,953,890</u>	<u>250,000</u>	<u>889,461</u>	<u>96,564,862</u>
Unspent Budget Authority	\$ <u>136,716</u>	\$ <u>1,042,774</u>	\$ <u>16,024</u>	\$ <u>72,612</u>	\$ <u>533,336</u>	\$ <u>3,717,864</u>	\$ <u>43,757,201</u>	\$ <u>134,125</u>	\$ <u>44,254</u>	\$ <u>49,454,906</u>
UNSPENT BUDGET AUTHORITY BY FUND										
General Fund	\$ 28,397	\$ 2,015	\$ 1,296	\$ 19,083	\$ 1,893	\$ 733,960		\$ 134,125	\$ 1,552	\$ 922,321
Special Revenue Fund	108,319	1,040,759	14,728	53,529	531,443	2,983,904	\$ 29,588,189		42,702	34,363,573
Capital Projects Fund							<u>14,169,012</u>			<u>14,169,012</u>
Unspent Budget Authority	\$ <u>136,716</u>	\$ <u>1,042,774</u>	\$ <u>16,024</u>	\$ <u>72,612</u>	\$ <u>533,336</u>	\$ <u>3,717,864</u>	\$ <u>43,757,201</u>	\$ <u>134,125</u>	\$ <u>44,254</u>	\$ <u>49,454,906</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.

Additional information is provided in the notes to the financial schedules beginning on page A-11.

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 2002

1. **Summary of Significant Accounting Policies**

Basis of Accounting

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (General, Special Revenue, and Capital Projects) and certain liabilities of defined benefit pension plans and certain post employment healthcare plans. In applying the modified accrual basis, the department records:

Revenues when it receives cash or when receipts are measurable and available to pay current period liabilities.

Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual leave and sick leave when used or paid.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The 2001 Legislature modified the fund structure established in section 17-2-102, MCA, to implement the changes made to generally accepted accounting principles (GAAP) by Governmental Accounting Standards Board (GASB) Statement 34. These changes were effective July 1, 2001. Department accounts are organized in funds according to state law applicable at the time transactions were recorded. The department uses the following funds:

Notes to the Financial Schedules

Governmental Fund Category

General Fund - to account for all financial resources except those required to be accounted for in another fund.

Special Revenue Fund - to account for proceeds of specific revenue sources (other than private purpose trusts or major capital projects) that are legally restricted to expenditures for specific purposes. Department Special Revenue Funds include Air and Army National Guard, Military Construction, and Disaster and Emergency Services.

Capital Projects Fund - to account for financial resources used for the acquisition or construction of major capital facilities, other than those financed by proprietary funds or trust funds.

2. **General Fund Balance**

The negative fund balance in the General Fund does not indicate overspent appropriation authority. Each agency has authority to pay obligations from the statewide General Fund within its appropriation limits. Each agency expends cash or other assets from the statewide fund when it pays General Fund obligations. The department's outstanding liabilities exceed the assets the agency has placed in the fund, resulting in negative ending General Fund balance for the fiscal year ended June 30, 2002. The General Fund balance for the fiscal year ended June 30, 2001, is overstated by \$2,227,315 due to an error in recording prepaid expenditures which overstated assets. The correct General Fund balance should be a negative fund balance of \$348,553 for the fiscal year ended June 30, 2001. These balances reflect activity at the agency and not the fund balance of the statewide General Fund.

3. **Expenditure Program (Subclass)**

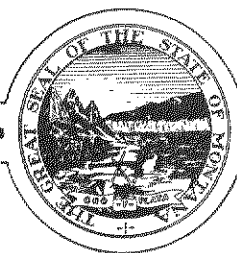
As part of the implementation of a new accounting system in fiscal year 1999-00, state officials determined that a subclass designation would identify the program to which expenditures should be charged. The program designations in the Schedules of Total Expenditures & Transfers-Out are based on the subclass designation used when the expenditures were recorded.

4. **Direct Entries to Fund Balance**

Direct entries to fund balances in the General and Special Revenue funds include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies.

Department Response

DEPARTMENT OF MILITARY AFFAIRS MAR 07 2003



JUDY MARTZ
GOVERNOR

LEGISLATIVE AUDIT DIV.
ARMED FORCES RESERVE CENTER
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OFFICE OF THE ADJUTANT GENERAL
MAJOR GENERAL JOHN E. PRENDERGAST
(406) 324-3000 - FAX (406) 324-3011

P. O. BOX 4789
HELENA, MONTANA 59604-4789

March 4, 2003

Sonia Powell
Financial-Compliance Auditor
PO Box 201705
Helena, MT 59620-1705

Dear Ms. Powell

In reply to the Financial Compliance Audit Report received by this office February 28, 2003, we are submitting the following comments:

Recommendation #1

We concur with your recommendation. Due to the continually changing requirements in these areas, this will be an ongoing effort of the department.

- A. The department is currently developing and implementing procedures, which will improve communications and coordination among program managers, and accounting personnel.
- B. The department is currently developing and implementing procedures, which will provide additional training for its program managers, and accounting staff.
- C. The department is currently developing and implementing procedures, which will ensure compliance with, state accounting policy.

Recommendation #2

We concur with your recommendation. The current outstanding general fund loans were established on June 30, 2002. The department will have them repaid before June 30, 2003 and will ensure that all future loans are repaid within one year as required by law.

Recommendation #3

We concur with your recommendation. The department has been in compliance with state personnel policies regarding payout of vacation benefits when employees terminate since March 1, 2001.

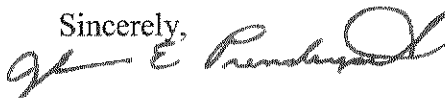
Recommendation #4

We concur with your recommendation. The department implemented procedures July 1, 2001 to ensure the CMIA spreadsheets contain accurate information in order to document compliance with the CMIA agreement. These procedures and the final CMIA spreadsheets for FY02 have been reviewed by the Department of Administration.

Recommendation #5

We concur with your recommendation. The department has been in compliance with federal matching requirements for the Youth Challenge program since July 1, 2001.

Sincerely,

A handwritten signature in dark ink, appearing to read "John E. Prendergast", written in a cursive style.

Major General John E. Prendergast
Director